Ep:3 Man vs. Machine

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PATTI BRENNAN: Welcome to "The Patti Brennan Show." Hey, whether you have $20 or $20 million, this episode is for those of you who want to protect, grow, and use your assets to live your very best life.

Joining me today is Eric Fuhrman. We're going to be talking about behavioral investing. Now, I know that sounds odd, right? Of course, we all want to think about, "Oh, that middle thing. I want to grow my assets. To do that, I'm going read the 'Wall Street Journal' every day, look at the business section, and watch CNBC. That's how I'm going to make more money." Right?

Well, Eric and I are going to talk today about, really, what is the big driver of investment investor returns? Not just investment, investor returns. Eric, thank you so much for being here today.

ERIC FUHRMAN: Patti, I wouldn't spend my time any other way.

PATTI: All right, good deal. Good deal. Let's talk about, really, the three things. There are three major things that contribute to how well a person does in their 401(k), or their portfolio. Why don't you tell our listeners today what are those three things?

ERIC: I think when you look at it, obviously one of the important things that drives long term returns, and again, the focus here is long term returns, but number one is going to be your asset allocation, your overall mixture between stock and bonds.

That's really going to dictate the volatility, but also the long term returns in your account, investment selection and...

PATTI: Hold off, can I just stop you there? Because a lot of people listening today, they hear this thing called asset allocation, and all of a sudden, I can just imagine that your eyes are beginning to glaze over, and think, "Oh, God. This is so boring."

What exactly is asset allocation? What is it in English, Eric?

ERIC: Asset allocation is just really the mix of different investments that you own in your portfolio. For example, that would be the different type of stocks that you might own, it could be bonds, it could be cash, it could be this new emerging area called alternative investments, but the idea is they're really just investments that react to a set of economic conditions in a different kind of way.

Essentially, everything is not moving in the same direction at the same time in the same order of magnitude.

PATTI: One of the things that we tell people is that asset allocation really isn't the same thing as diversification. You could be well diversified by going to 12 different banks and getting a CD from these 12 different banks. That's diversification, but that's not really asset allocation because it's all the same kind of investment.

Asset allocation takes it to another level, to make your returns more, I hate to use the word predictable, but more resilient in various economic scenarios because nobody really knows what's going to happen in the near term, or frankly, even the long term. We want you to be able to participate in it, but not get killed, you know?

It's using that same metaphor with baseball. Just hit a whole bunch of singles. Don't worry about the home run. In baseball or many games in life, the people who hit a whole bunch of singles end up winning the game.

Asset allocation number one. What's number two?

ERIC: Investment selection and diversification. Again, a lot of people think if they own a bunch of different investments, they're diversified. That might not be necessarily true. You have to think again about the different types of investments that you're going to own in your portfolio.

The third thing, which is really the focus of this podcast, is behavior. I think that's often the most overlooked and missing element. Ultimately, the behavior of the investor is going to be the long term determinant of whether or not you realize successful long term returns in the market.

PATTI: When we think about behavior, I think back to my four children. I think about behavior when they were toddlers. That's not really what we're talking about. It's really, what do people do? What is the natural instinct that you want to do when things are going really well, or not so hot?

What I think is interesting and really brings this home for people are the DALBAR and Lipper studies. They've been doing these studies year after year after year. What is amazing to me is how consistent the results are. Eric, why don't you share with us what they are?

ERIC: Again, this is going back from 1998 to 2017. We're basically covering roughly a 20 year period. DALBAR's been doing these studies for a really long time.

The essence here is to show that when you look at the returns of different areas of the market that are quoted, let's say the S&P 500 or even a diversified portfolio, 60/40 portfolio and so forth, oftentimes the average investor not only underperforms the market, but more importantly, they actually underperform the very investments that they own.

Again, the result of that is from behavior. If you look, for example, over the past 20 years in this study this is a very general categorization bonds on average generated a 5 percent annualized average return. A 60/40 portfolio between bonds and stocks earned about 6.4 percent. The S&P 500, an all equity portfolio, did 7.2 percent.

The average investor generated a 2.6 percent rate of return. Again, even if you just think about a blended portfolio, they underperformed by almost 400 basis points or 4 percent per year, on average, which is huge. A lot of that can potentially stem from the behavior of that individual.

PATTI: Basically, what I think is interesting about the DALBAR studies is, they've been doing these studies for the last 20 years. They take rolling periods of time. This happened to be the last 20 years. The year before, it was from the 20 years prior.

It's also interesting, even in shorter time periods, that people tend to confuse investment returns with investor returns. It's a very big deal and it's a very big difference. What causes that difference?

ERIC: Again, I think you have to look, really, at the sources. I think part of it, no fault of their own, is the investment community. I think there's a hyperfocus. Whether it's somebody who watches the business news or a lot of commercials that come on TV, the focus is on what investments to be in and when to be in them. What and when are the key things that are coming across.

Ultimately, poor investor behavior arises from this emphasis, this hyperfocus on timing and selection as the primary drivers of return. If I can go back to when we just started out this podcast, that asset allocation and behavior are really the critical determinants that people have to think.

I'm reminded by a great quote from Bobby Jones. Some of you in the audience who may not be golfers, he was the Tiger Woods of his day back in the '20s or '30s. He has a quote that I think really parallels this theme, this narrative of behavior. He basically said, "Competitive golf is played mainly on a 5.5 inch course, the space between your ears."

Ultimately, to me, behavioral investing is all about the space between your ears and how you react that determines on making the difference between the average investor and realizing the returns that the market can offer.

PATTI: You know, it's a really good point. I think that, as well intentioned as the media is...and they are, they generally want to give people information...the problem is that there's almost too much information. We also have to keep in mind, let's face it. It reminds me of the story about the guy who was a fisherman.

He's a fisherman, right? He goes into the bait and tackle shop, gets all of his stuff, puts it in his basket, comes up to the counter, drops it all off on the counter, and says, "Do fish really like these lures?" The guy behind the counter says, "Well, I don't know. I don't sell to fish."

ERIC: [laughs]

PATTI: The point here is that TV, newspapers, they're not really selling education. They're selling to their advertisers. People will watch. They will read. They will pay attention when things are being hyped up. That's often the antithesis of making good decisions.

When people get emotional, get all ramped up, that's when you want to take a step back and say, "OK, what does this really mean for me?"

ERIC: Right, and Patti, I couldn't agree more. By the way, in your joke, I would be the guy that's buying all the lures, and probably not asking the questions. I'd be buying the shiny objects.

I think your point is well taken. When you think about the messaging that's being put out there today to today's people that are investors or even retirees, it's this narrative of take control, about empowerment to make decisions. I think, as Americans, that speaks to our cultural heritage. We love that idea.

The reality is, this process has been occurring since the 1970s. We have moved from a defined benefit retirement system to defined contribution through the 401(k). The reality is that those critical decisions about funding, about investing, have been placed squarely in the palms of every individual investor's hand.

I think the issue that we have when it comes to the messaging is that the focus is on more data and news. It's about being able to make lightning fast decisions, to be able to be quick. There's a premium on speed.

My feeling on this is that it cultivates a transactional and reactive person. It's really highlighting, as you said, behaviors that are antithetical to realizing the long term returns that the market can offer. Could you tell us, maybe, about some of the solutions that you would think that are important for them to look at?

PATTI: It's really interesting. I think a really interesting statistic…I wish I could cite it to the wonderful people who have published this. It's consistent, and for you and I, it's common sense. There is an inverse relationship to a person's results with how many times they make changes.

The more someone makes a change in their portfolio, the lower their return. This doesn't mean that you set it, and forget it, and never look at it again. It does need to be monitored, but this rapid fire change based on what's happening, what the latest guy or woman said, it really works against you.

The thing about it is, and I understand because we watch it too, it's important to get the data and understand what people are listening to. The thing is, it sounds really good. It sounds really smart.

You don't want to make long term decisions based on what your life is going to look like, or how to create the life that you want, based on what some guy said at six o'clock last night.

ERIC: Yeah, totally. I'll tell you what, what I think is a great segue into this next part is really to crystallize this in the minds of our listeners for both them to really distinguish and say, "What does this performance mindset truly look like versus somebody who has an outcome or goal oriented mindset?"

Our premise on this is really that really investment decisions need to be tethered to a goal based framework that is ultimately anchored by a long term financial plan. Really, that plan is going to then dictate the asset allocation. The plan itself and the asset allocation are going to be the things that drive really the long term returns for the result.

PATTI: It's interesting because I often tell people I think, and frankly, again, even people in our own industry do this completely backwards. They look at the different choices that they have in their 401(k), and they say, "Well, this one looks good and this one did really well. And I'll do a little bit of that," etc.

That's the last thing that you want to do. The best way you approach this stuff is to say, "OK, what do I want in my life? What's the outcome that I'm looking for? What do I want this money to do? When do I need it? What's realistic, given our resources?"

You start with the big picture. Once you have that laid out, you figure out, "OK, how much do I need to save per month to put my kids through college, be able to retire in comfort and maybe get a house, a second home, if we accomplish those things."

This is the fun stuff that comes along with real financial planning. You start with the big picture, then you get down to, "OK, what's the combination of cash, bonds, and stocks that will give us the highest probability of earning the rate of return that we need to do all those wonderful things in our life?”

Then you say, “Hey, should I pick investment A or investment B?” That’s the last thing you do, and by the way, you do want to monitor it because things are not going to continue exactly in a straight line, and you make adjustments from time to time.

ERIC: Absolutely. I couldn’t have said it better.

PATTI: We’re outcome oriented. It’s a very subtle difference that we hear and we see on a day to day basis. Let’s give our listeners and viewers a feel for the nuances between the two different mindsets.

ERIC: Sounds good. Do I get to be the performance guy and you can be the outcome oriented person?

PATTI: I’ll be outcome.

ERIC: Perfect. If I’m a performance mindset, I might think my mindset might be under maybe the following. Let’s start with number one. Patti, here’s the deal. I want a return that beats the market because that’s what I need to retire.

PATTI: That is very different than someone who’s outcome oriented. Someone who’s outcome oriented wants an income they could never outlive.

ERIC: Oh, there you go. That’s good. How about this? Patti, I only buy four and five star funds to ensure that I’m going to get good returns in my portfolio.

PATTI: An outcome oriented person understands that those stars have to do with past history, and are completely irrelevant as it relates to how is it going to do in the future. An outcome oriented person is looking for a portfolio that provides the highest likely of earning the lifetime returns that they need to accomplish their goals.

ERIC: How about this one? Patti, I think I should invest more in pharmaceutical stocks because their returns have been incredible. They are going through the roof.

PATTI: An outcome oriented person says, “OK, that sounds great, but again, they’re already going through the roof. It’s already happened. I want enough exposure to participate in attractive industries, but not so much to undermine my chance of success.”

ERIC: Last point here, Patti. I hear what you’re saying, but this market has been going crazy. It has got to go down at some point. I think it’s time to get out of all my stocks.

PATTI: An outcome oriented person says, “Well, gee, I know the market. It is volatile right now, but I still want to put my kids through college. I still want to retire. I still would love to have that second home, so I'm not going to change my investment policy for something that happens to be happening right now."

ERIC: Wait a minute. If I hear right what you're saying, basically, if my financial plan hasn't changed, then I shouldn't be changing my investments?

PATTI: That's exactly right. Remember, a financial plan, let's kind of talk about that because it tends to be this kind of nuanced thing. What's a financial plan? All a financial plan is are the steps that you need to take to accomplish the things that you want to accomplish in a cohesive package.

Understanding what your resources are, understanding what your desires are, it's a set of progressive strategies to get what you want.

ERIC: Beautiful. Absolutely. How about next, why don't we transition a little bit here, and let's go back and talk about the experts? You can't help it in this day and age, in the age of communication, we are constantly bombarded with what the market is doing through the little tickers and little informational windows they have on all the business news channels.

People are always talking about what you should be buying or selling, why the market's going up, why is it going down? It really creates this mindset, at least when we talk to a lot of investors, where they always feel like they should be doing something.

I think maybe we could reference the Survey of Professional Forecasters. This is actually produced by the Philadelphia Fed, which is actually not too far from where we're located. This is one of the oldest quarterly surveys of macroeconomic forecast in the United States dating all the way back to 1968, I believe.

It's distributed every quarter, but it's meant to provide forecast for GDP and inflation. They usually have a number of panelists, 30 or more panelists from some of the top investment industries, academic research industries across the country.

It's really the consensus of all these people about what GDP and inflation might be like.

PATTI: We should be listening to the Philly Fed because, after all, these are really smart people. Don't they know more than we do?

ERIC: Exactly right. You would think of anybody, forget about the nightly businesses that you might see. These are very credible people in the industry that you would think have a good history of success.

When you look at the forecast that come out, what you find are, number one, the range depending on whether you go out a year or two years out, the range is very wide. It's a little bit difficult to say the market could have a massively different reaction to say one percent GDP versus three.

The forecasts are very wide in terms of their accuracy, but then they also tend to miss crucial turning points.

Case in point, if you look back into the report that was filed in the fourth quarter of 2007, there was a prediction that GDP in 2008 was going to be a positive 2.5 percent. The actual result was a negative 2.5.

Now, we're probably picking them on a little bit because that was an extreme event, but it just goes to show that, again, there was a forecast, and then there was reality.

Their assessment of negative GDP in 2008 was a negative five percent...I'm sorry, was about five percent that we'd have negative GDP, so it's about 1 in 20, if you work that out. Again, missed a crucial turning point, and we're using the Professional Forecaster Survey.

PATTI: It just goes to show you that statistics really don't tell you much, especially when you're averaging things out. I think it's really important that our listeners and our viewers understand, that nobody really knows what's going to happen in the future.

This is one of those areas that the more...I often talk about this, we don't get to queue. We don't pretend to know what's going to happen. The more somebody has this strong position, the firmer they believe it, the less I respect that person, because nobody can be that confident and that sure.

ERIC: The ability to be flexible. You remember the old joke, that economists have predicted nine out of the last six recessions correctly, so it just goes to show.

PATTI: I think for those of us who do this on a day to day basis, it's interesting to get a sense of the cycles, and understand what's happening on a real time basis. I think that's valuable.

What I don't think is valuable, is trying to anticipate and predict what it's going to be three months or a year from now. I think that could sabotage people, and it could make them do things that are really not in their best interests.

ERIC: That actually brings us to the next point, which is short term volatility. This is actually highly relevant if you look at the month of October and into November here.

We've had some really extreme moves in the market, a lot of short term volatility. Folks at home that may be opening their October, and even November statements, might see a rather large departure in that account value from a month to month basis.

Talk a little bit about short term volatility, and how that can influence somebody to make, potentially, a bad decision, just by reacting on what's happened over, say, the last month.

Patti: It's really interesting. We had a meeting early this morning, and the clients came in and they brought their October statements. Their October statements showed that they were down a lot of money, it was about a 10 percent loss.

Theirs was an unusual situation, most clients' weren't. It was fascinating, because what they didn't realize, is on a year to day basis, they were flat. They were so focused on this one month that they didn't realize, "Oh, I didn't lose any money this year. It was just in the last month."

In other words, they basically gave back what they had earned earlier in the year, but that's not what they were focusing. They were focusing on the most recent loss. The key here is to understand that over short term periods, whether it be a month, three months, etc., markets are going to do their thing. Let's talk about the probability of success in your investments over different periods of time.

There's a chart that we're going to put up that talks about the last 20 years. In the last 20 years, if you look at what's happened on a daily basis, markets were up 53 percent and down 47 percent.

On a week by week basis, it was a little better. 56 percent of the weeks, it was up, 44 percent of the weeks, it was down. Monthly, 61 percent, 39 percent. If you just hung in there for a full year and didn't do anything, 80 percent of the time, your portfolio would've been up. Again, if it was 100 percent in the S&P 500, versus 20 percent it was down.

Again, we talk a lot about, "Think long term, think long term," and you're probably out there thinking, "Yada, yada, yada, I hear that all the time, it's so trite."

Eric: [laughs]

Patti: There's a reason why we do that, because it really does make a difference. If you can just understand, again, be outcome oriented and ignore the noise, markets lose 14 percent on average, once a year. Understand, if you have any of your money invested in markets, you're going to have periods where it is down. Ignore it. Go into a coma if you have to.

Eric: [laughs]

Patti: Don't open your statements. The key here is, don't do anything about it.

Eric: I think there's also a quality of life issue here. If you're somebody that watches, just remember, just being exposed to the market by, say, watching TV, looking at your statements day in and day out, that doesn't necessarily lead to higher quality decisions.

What some of these numbers lead to, that Patti just highlighted, is that shorter time frames leads to worse odds of success. Just think about in terms of your emotional state, the time that you're spending. If you're looking at daily returns every day, you're checking the market, over the course of 10 years, several thousand times.

Think about the time you save, and the emotional mindset of somebody who looks at it once a year, 10 times. They're probably feeling a lot better about things, than somebody that's checking it each and every day, and experiencing that roller coaster of being up and down, over and over again.

The other important part is, just think about it too is, if you're looking at it every day and it causes you to be transactional, you have to be right not once, but twice. If you're going to sell, that means you have to buy, and what you have to buy is, hopefully, going to end up better than the thing that you had just previously sold.

Long term, again, I think the numbers are there to show that frequent decision making is usually at odds with your long term success.

PATTI: Eric, it reminds me of the story of what we did during the tech bubble. During the tech bubble, markets were really volatile. It was an unusually long bear market.

Typically, we'll have people who come in calling, concerned, worried. The first year, I was able to keep them comfortable, confident, they didn't do anything. Second year, kept them comfortable, they were really getting a little bit more scared. It was the third year, that's when it all happened.

We kept track of the clients. Let's say that we, at the time, had 400 clients. I was able to keep everybody confident, comfortable, etc., except for seven people. We did this thing, we tracked what the Dow and the S&P 500 were. The day that they called, nobody sold out completely, but we moved a portion of their portfolio out.

We logged what the S&P was on that particular day, and then we just waited. Not once, not twice, but in every single, solitary time, those same people...so they sold when the market was down. The market, in many cases, continued to go down.

Initially, those clients felt really good, "I made the right decision, we moved out. That was really smart." What happened was, as the markets started to recover, and it recovered and it recovered, not one or two, all seven clients called and came in, and said, "Hurry up, we gotta get back in." In every single case, they got back in when the market was much higher than what it was when they pulled out.

ERIC: When they sold out.

PATTI: It's human nature, I understand that. Again, I often say it to people in this podcast, part of what we're here to do is to, first of all, create a portfolio that that person can live with, so that they don't panic. That they're not in that situation, and they understand the process and the thought that went in to putting those investments together.

ERIC: I think another way of saying this is, focus on what you can control. What do you think are the elements for an investment's success, if we think about, what are the things that we can control?

PATTI: Exactly. We can't control markets, we can't control what they do or when they do, but we can control what we do about it when these events do occur. Eric, let's talk about, what are the most common mistakes people make when it comes to what they do.

ERIC: The first one I'd say is, maybe overdiversification. It seems like you can't possibly have overdiversification, but the reality is, it can take several different forms. I think one of the common things that we see on a regular basis when we look at people's portfolios, is that they end up having a lot of overlap.

For example, they may own 5 or 10 large cap stock funds. Really, even if these are some of the best managers that you could ever buy, in terms of a large cap stock fund, the reality is, you just own a more expensive version of an index fund by just owning multiple funds in the same category.

PATTI: It just goes to show, it's much easier to buy an investment, it is much harder to sell it.

ERIC: [laughs] So true. I think another area is probably panic. I'm sure you've heard the saying all the time, "This time, it's different."

PATTI: Absolutely, we hear it all the...

ERIC: It's never different. Who was it, Samuel Clemens, or Mark Twain, once said that, "History never repeats itself, but it does rhyme"? I think that's true to the market.

PATTI: What's interesting is, if we go back to earlier, what makes people feel like it's different, is what they hear in the media. The media is pushing that, and saying, "This is really different, it is different." The catalyst is often different, what causes it could be different, but the mechanism, the result, it's usually the same.

ERIC: I think it really stems from this irrational fear, that basically, that the client is never going to end, that there's a loss in faith in the future, that this long term upward slope in the equity markets is somehow forever broken, that it will never be repaired.

PATTI: Here's one that we often get, and that is, "Well, wait a minute, if I sell this investment, I'm gonna have to pay all of these taxes," or the other side of that is, "Wait a minute, I've lost this money. I wanna wait until it recovers."

ERIC: Yes, oh my gosh. This is such a good one, too, because this is one that is really hard when you talk to people, to get them over and around this emotional bias...

PATTI: Hurdle.

ERIC: ...or hurdle, if you will, is that somehow the basis, what you paid for the investment, somehow has anything to do with the fundamentals of that investment, and whether or not it should be held or sold, or if it's a significant risk in the portfolio.

PATTI: In other words, that stock or that large cap fund has no clue what you paid for it, nor does it care. If the CEO of the company doesn't know how his company is going to do next quarter, why should you be making investment decisions based on what you pay for it?

ERIC: In a lot of situations, you could have a highly appreciated stock, and people don't want to pay the tax. The reality is, folks, if you look back to whenever the capital gains tax was initiated, it has never been lower than where it is today.

The cost to get out of a highly appreciated stock is lower than it's ever been. For some people, a part of that could be at zero percent, depending on your tax bracket.

PATTI: We both know people who have investments in companies like GE, and CISCO, etc. They never wanted to sell...

ERIC: ...because of the tax.

PATTI: ...because of the tax. Boy, when looking back, they would be very happy to have kept 85 percent of what they earned.

ERIC: Remember, too, that any stock, a single stock, could easily move 20 to 30 percent, up or down, in a single year. A 15 percent tax on the gain is a small price to pay to protect and remove the rest out of harm's way. Even, what about people with stock at a loss, where they say, "I have to earn back my investment. I can't sell, because I'm at a loss"?

PATTI: You know what I always say on this one, and Eric, you've heard it a million times, my question is, if you paid $10,000 for something and now it's worth $8,000, the question to ask yourself is, "If I had $8,000 of cash today, would I be buying that stock?"

If the answer is, "Yes," you want to hold it. If the answer is, "No, there's no way I would ever buy that stock again. Are you kiddin' me, Patti? I lost money," then the answer is, you need to sell it, because that's the reality. You have $8,000. What are you going to do with it?

ERIC: By the way, that's not an exaggeration, I actually have heard it 10,000 times. [laughs]

PATTI: I'm sure you have. It's a common thing, it's just human nature.

ERIC: It is, very common.

PATTI: We have to understand human nature, and then frame it in a way that people say, "Oh yeah, that's right. You probably make sense."

ERIC: What about, we hear this in a certain population of the client as well, is that they believe when they go into retirement, that they want to invest for yield? They don't invest for total return, they expect that they're going to be able to live just on the interest or the dividends that their portfolio throws off.

Is it that realistic, and does it make sense?

PATTI: Wow. My first response that came to my head when you said that is good luck. Good luck with that one because when you look at yield, if you're lucky, the yield that you get on your investments is just keeping pace with inflation. Most of the time, it doesn't. Then you have to pay taxes, etc.

The key here is giving yields today. Is that realistic? Is that going to replace your salary because that's what you need to do when you retire? Total return, I believe, is a much better framework to look at your investments because the key here is let's ignore that word, income, from your investments.

What you need is cash flow. What's the best way to create the cash flow that you need to live the very best life that you want to lead? How are we also going to make sure that that cash flow is growing with inflation?

By the way, it's really important, especially for retired people because people who are retired feel inflation more than people who are younger.

ERIC: Absolutely. To give you an example, the St. Louis Fed publishes numbers on this. The 10 year AAA corporate bond, as of the end of September, was paying just a hair over four percent.

If you're somebody that, say, needed $6,000 a month to live on, $72,000 a year, if you were just going to live on the interest, you'd need nearly $1.8 million just so you're extracting the interest. If you've a more diversified portfolio, the dividend yield on stocks is even lower than that.

You would need a significant amount of capital if your goal was just to live on the income alone.

PATTI: What we're not even paying attention to is that $72,000 and using those numbers, that $72,000 isn't growing. You're just using all of the interest. Well, 10 years from now, you're going to need a lot more than $72,000 to buy what it buys today, especially with healthcare. Healthcare's rising at six percent per year.

It is astounding how much people have to spend. Even with Medicare and good supplemental plans, it's not a couple thousand dollars a year. We're talking 10, 20, 30 thousand dollars a year just for healthcare. It's growing much faster than average inflation.

ERIC: That's an excellent point because, again, as you said, people feel inflation differently when you're older and you consume a different basket of goods. What do you say, before we wrap up this podcast, that we play a little game between you and I?

PATTI: I love games.

ERIC: Who doesn't like a game? I have two kids at home. We play games all the time. Let's play a little game called, "Are you a speculator or an investor?" How about this?

PATTI: Sounds good.

ERIC: You want to start us off on this little one?

PATTI: Sure, I'll start off.

ERIC: Sounds great. Go on.

PATTI: Eric, I know the stock is down, but all the analysts say the company's going to turn things around the second quarter. Am I an investor, or am I a speculator? If so, why?

ERIC: Man, you gave me the softball pitch here. This is definitely a speculator when you look at it. Number one, they're talking about an individual stock. That tells me that, maybe, they're not properly diversified to begin with.

Again, if we're just focusing on a single investment and what the analysts say, the fact that the stock is down, you are speculating on that investment. You're hoping for it to go up. The more important thing is to look at the fundamentals.

Is the risk of that investment appropriate for your portfolio in your long term financial plan? This is definitely in speculator territory for sure.

PATTI: Perfect. Sounds good. All right, your turn.

ERIC: Gotcha. Here it comes. Patti, everybody knows we are going to have a correction at some point. Look how much the market has gone up. I think it's time to sell and go to cash.

PATTI: You're a speculator. By the way, I agree with you. The market is going to go down at some point in time. You know what, we don't care. We're not going to pay attention to that.

We're going to assume that it is going to go down, but we also understand that you've got a beautifully crafted, well diversified portfolio that is far more resilient than you might even realize.

ERIC: Perfect.

PATTI: My turn.

ERIC: You got it.

PATTI: Let me see. Going back to you. I'm comfortable holding an investment for 10 years or so. I'd like to purchase some growth stocks. Am I an investor or a speculator?

ERIC: I'll tell you what, that's music to my ears. You sound like an investor to me. Now, let's keep in mind here, again, the big defining characteristics here is that you're comfortable holding an investment for 10 years.

You have a long time horizon that suggests to me that you're willing to stay invested through the ups and downs, even though you said that you wanted to invest in growth stocks. Again, this is one area of the market. You're looking for a long term time horizon.

As long as that growth stock allocation fit in with your long term financial goals, then it could definitely be appropriate. Again, time horizon here and your comfort level of staying in something for a long period of time. You're an investor.

PATTI: Also, the key here is to make sure that you've got something to balance that thing out, so you've got complementary assets.

ERIC: Absolutely.

PATTI: Excellent. Go ahead.

ERIC: My turn. I know this stock is most of my portfolio, but I can't sell it. My mother worked for the company 30 years before passing it on to me. Are you an investor or a speculator?

PATTI: You're a speculator, but you also have a sentimental attachment to that stock, don't you? That's important to recognize. I think that your mom would have wanted you to enjoy whatever that company did for her. She worked there for 30 years. They were good to her.

She gave you that stock because the company was good to her. Let's acknowledge that. Now think forward and say, "What would your mom want for you today? Would she want all of your eggs to be in that one particular company?"

Maybe, it might make sense for you to take a portion of it and keep it if that sentimental attachment is important to you. Then take the balance because your mom would have wanted you to be diversified.

When you were little, she didn't feed you eggs every morning, noon, and night. You had a diversified meal plan. She gave you lots of different things. It's the same thing with your portfolio. She'd want your portfolio to be as well balanced as your meals were.

ERIC: Well balanced diet.

PATTI: I've never used that metaphor before. It's a weird one.

ERIC: [laughs] First time ever, right?

PATTI: These things pop into my brain, Eric. I have no idea where they come from.

ERIC: I gotcha. I didn't hear dessert in there anywhere.

PATTI: Mm. OK.

ERIC: I guess it's your turn.

PATTI: Let me see. The market's fallen about 10 percent since the beginning of the year. I feel like now is a good time to get in. I'm comfortable making this investment as part of my long term investment plan. Am I a speculator or an investor?

ERIC: I would say, in this case, that you would be an investor. Again, because of the context of how this is framed is that, yes, the market has fallen 10 percent, but you're comfortable getting in. You're comfortable with the risk, acknowledging that the market has gone down, but with the idea that this is going to be part of your long term financial plan.

You were not transactional, that you have a very long term view on things. You're willing to be patient and wait. I would say you would definitely be an investor.

Warren Buffett had a great quote. He said, "The market is a very efficient mechanism for transferring money from the inpatient to the patient." Again, patience is key.

PATTI: Terrific. Let's pull all of this together. Let's bring this together. We've got three points that we want to make. Number one, don't let your emotions get in the way to good decision making. Number two, do not, please, please, please don't let short termism impact your decision to what you do. Short termism is a disease that is usually fatal.

Number three, focus on your outcomes. Remember, it's all about your outcomes not your performance. It's about your financial plan. The plan is just a series of steps that you're going to take to accomplish the things that you said you wanted to accomplish in a cohesive plan that is based on your resources and what's realistic over time.

Focus on your outcomes, forget performance. That's short termism. That's the disease and understand that you're a human being. When in doubt, talk to your advisor. Talk to a professional. Make sure that before you do something that could be fatal, that you've gotten a second opinion.

That's it for today's show. Thank you so much, Eric, for joining me today. This was an important topic.

For those of you who might be interested in learning more, feel free to go onto our website, keyfinancialinc.com. I know you're probably driving in your car, or you might be watching it on TV. We are open to any questions you might have. We're happy to help you any way we can.

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That's what this is all about. We want to improve the outcomes for all Americans, not just you but your friends and anybody that you care about.

Thank you so much for listening to us today, watching the podcast. Thank you, Eric, for a great game session. I didn't realize we were playing games.

ERIC: I enjoyed it.

PATTI: Again, don't forget to hit "Subscribe." Share it with your friends and join us next week. Take care. Have a good one.